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ACTION EUR-12

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TAGS: ECON, OECD

SUBJECT: EDRC ANNUAL REVIEW OF UK, JANUARY 23

REF: A) OECD DOCUMENT EDR(75)L; B) AMMERMAN-GERVERS

TELECON, JANUARY 16

1. SUMMARY: OECD SECRETARIAT IS PESSIMISTIC ABOUT
UK ECONOMIC PROSPECTS AND CONSIDERS OUTLOOK FOR IMMEDIATE
FUTURE TO BE UNSATISFACTORY. DRAFT ECONOMIC SURVEY
FOR UK NOTES PRESENT SIZE OF BALANCE OF PAYMENTS AND
INFLATION PROBLEMS PRECLUDE COMBATTING UNEMPLOYMENT BY
FURTHER RESORT TO REFLATIONARY ACTIONS. BEST THAT CAN
BE DONE WITHIN RESTRICTIVE OVERALL DEMAND
MANAGEMENT IS TO ATTEMPT SLOW DOWN RISE IN UNEMPLOYMENT,
ENCOURAGE INVESTMENT AND EXPORTS. SECRETARIAT
RECOMMENDS CONSIDERATION OF STATUTORY INCOMES POLICY TO
LIMIT NOW DOMINANT WAGE-PUSH ELEMENT OF DOMESTIC
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INFLATION. MAIN ISSUES FOR DISCUSSION AT ANNUAL REVIEW

WILL BE (1) RAPID RISE IN INFLATION AND MEASURES TO CONTROL IT; (2) RISK OF LABOR "SHAKE-OUT" AND MEASURES TO AVOID IT; (3) WEAK OUTLOOK FOR MANUFACTURING INVESTMENT AND MEASURES TO STIMULATE IT, AND (4) PROSPECTS FOR CURRENT ACCOUNT DEFICIT AND ITS FINANCING. ACTION REQUESTED: AS US IS EXAMINING COUNTRY AT ANNUAL REVIEW, WE WOULD APPRECIATE ANY WASHINGTON COMMENTS OR QUESTIONS. END SUMMARY.

2. OUTPUT AND DEMAND: SECRETARIAT FORECASTS INCREASE IN REAL GDP OF 1.5 PERCENT IN 1975 ON BASIS OF PRESENT POLICIES WITH GROWTH LIMITED TO FIRST HALF OF YEAR. MAIN DEMAND COMPONENTS SHOW GENERAL WEAKNESS, WITH SLOW GROWTH OF CONSUMER AND PUBLIC EXPENDITURES, ALMOST NO GROWTH IN PUBLIC INVESTMENT AND SHARP DECLINE IN PRIVATE INVESTMENT. SECRETARIAT CONSIDERS OUTLOOK FOR MANUFACTURING INVESTMENT TO BE MATTER OF SERIOUS CONCERN AND ATTRIBUTES WEAK BUSINESS CONFIDENCE TO POOR PROFITABILITY, CONTINUING TIGHT LIQUIDITY, RAPID INFLATION, WEAK DEMAND AND UNCERTAINTY ABOUT GOVERNMENT PLANS FOR INDUSTRY AND COMMON MARKET. SECRETARIAT SUGGESTS REDUCTION IN CORPORATION TAX TO IMPROVE CORPORATE LIQUIDITY AND RAISE CAPITAL EXPENDITURE, AND THUS HELP EASE PROSPECTIVE WEAKENING IN LABOR MARKET.

3. EMPLOYMENT: SECRETARIAT EXPECTS UNEMPLOYMENT TO RISE SUBSTANTIALLY DURING 1975 TO ABOUT 3.5 OR 4 PERCENT OF LABOR FORCE BY END OF YEAR FROM 2.7 PERCENT IN NOVEMBER, 1974. HOWEVER, IT IS POSSIBLE THAT SLUGGISH DEMAND, ACCELERATING INFLATION AND CONTINUING TIGHT FINANCIAL POSITION OF COMPANIES COULD COMBINE TO PRODUCE EVEN MORE MASSIVE SHAKE-OUT OF LABOR IN ABSENCE OF APPROPRIATE POLICIES TO RESOLVE THESE PROBLEMS.

4. PRICES AND INCOMES: SECRETARIAT FORECASTS ALMOST 20 PERCENT INCREASE IN RETAIL PRICES IN 1975. MAIN IMPETUS TO INFLATION WILL BE WAGES , WHICH EXPECTED TO RISE BY 25 PERCENT. IMPORT PRICES SEEN RISING LIMITED OFFICIAL USE

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LESS RAPIDLY IN 1975, ASSUMING STABILITY IN EXCHANGE RATE. (SECRETARIAT RECOGNIZES THAT STABLE EXCHANGE RATE ASSUMPTION IS BIG QUESTION MARK.) PROSPECT FOR INCREASE IN REAL EARNINGS DURING 1975 IS SLIGHT AND THIS WILL CONTRIBUTE TO CONTINUING WEAKNESS IN PRIVATE CONSUMPTION.

5. SECRETARIAT BELIEVES THAT PRIORITY MUST BE GIVEN

TO REDUCING RATE OF INFLATION AND CURRENT EXTERNAL
DEFICIT, IF IT IS TO BE POSSIBLE TO PREVENT MAJOR SLUMP
IN BUSINESS FIXED INVESTMENT AND TO COMBAT UNEMPLOYMENT
BY REFLATIONARY MEASURES. SECRETARIAT SUGGESTS THAT
UK SHOULD AIM FOR RISE IN PRICES AND WAGES OF AROUND
9 TO 12 PERCENT RESPECTIVELY, I.E. ABOUT HALF OF
EXPECTED INCREASES ON BASIS OF PRESENT POLICIES. IF
VOLUNTARY ARRANGEMENTS BETWEEN EMPLOYERS, TRADE UNIONS

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AND GOVERNMENT ARE INSUFFICIENT TO ACHIEVE THESE GOALS,
SECRETARIAT CONCLUDES THAT SITUATION IS SO SERIOUS AS
TO WARRANT INTRODUCTION OF STATUTORY INCOMES POLICY.
FAILURE TO ACHIEVE MARKED DECELERATION IN INFLATION WILL
INCREASE PROBLEMS IN OTHER AREAS OF ECONOMIC POLICY,
PARTICULARLY EMPLOYMENT: ACCELERATING PAY CLAIMS MAKE
LARGE-SCALE DISMISSALS OF LABOR A POSSIBILITY;
PROSPECTS FOR REDUCING UNEMPLOYMENT THROUGH DEMAND-

MANAGEMENT POLICIES MAY BE VERY LIMITED GIVEN PAST
EXPERIENCE THAT INFLATION RATE UNLIKELY TO BE
INFLUENCED BY GROWING ECONOMIC SLACK; CONTINUED RAPID
INFLATION MAY HAVE ADDITIONAL DEPRESSIVE EFFECT ON
INVESTMENT INTENTIONS AND WEAKEN EMPLOYMENT PROSPECTS
STILL FURTHER.

6. BALANCE OF PAYMENTS. SECRETARIAT EXPECTS EXPORT
PERFORMANCE TO IMPROVE IN 1975. EXPORT VOLUME WOULD
RISE 4 PERCENT, SOMEWHAT LESS THAN GROWTH OF MARKETS
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(4.5 PERCENT), BUT TERMS OF TRADE WOULD SHOW SUB-
STANTIAL GAIN. IMPORT VOLUME EXPECTED TO RISE
RELATIVELY SLOWLY, REFLECTING WEAKNESS IN DOMESTIC
DEMAND. ASSUMING EXCHANGE RATE REMAINS STABLE, TRADE
DEFICIT IS FORECAST TO BE REDUCED FROM \$12 BILLION
LEVEL IN 1974 TO AROUND \$8.5 BILLION IN 1975. CURRENT
ACCOUNT DEFICIT ALSO EXPECTED SHOW MARKED REDUCTION
TO ABOUT \$6.5 - 7 BILLION FROM ESTIMATED \$9.5
BILLION IN 1974. SO FAR, UK HAS NOT ENCOUNTERED
DIFFICULTIES IN FINANCING EXTERNAL DEFICIT, AND
MEDIUM-TERM OUTLOOK IS BRIGHTENED BY DEVELOPMENT OF
NORTH SEA OIL RESERVES. HOWEVER, SECRETARIAT
STRESSES THAT ALTHOUGH INTERNATIONAL PRICE COMPARISONS
SUGGEST UK RETAINS CONSIDERABLE COMPETITIVE ADVANTAGE,
EXPORTS LIKELY TO REMAIN MORE SLUGGISH AND IMPORTS
MORE BUOYANT THAN MIGHT HAVE BEEN EXPECTED GIVEN
THIS COMPETITIVE ADVANTAGE.

7. MISSION APPRECIATES EMBASSY LONDON COMMENTS
RECEIVED BY TELEPHONE AND WELCOMES ANY FURTHER COMMENTS
OR QUESTIONS WHICH WASHINGTON MAY WISH TO PROVIDE.
WE NOTE IN PARTICULAR EMBASSY LONDON COMMENT THAT
EXCHANGE RATE ASSUMPTIONS ARE PROBABLY OPTIMISTIC IN
VIEW OF 1975 FORECAST OF DETERIORATION IN VALUE OF
STERLING OF 4 PERCENT BY NIESR AND OF 10 PERCENT BY
LONDON BUSINESS SCHOOL. MISSION INTENDS TO FOCUS
QUESTIONS ON MEASURES TO CONTROL INFLATION AND TO
INCREASE BUSINESS CONFIDENCE AND WILL FOLLOW UP
SECRETARIAT'S QUESTIONS ON INCOMES POLICY AND SOCIAL
CONTRACT BY ASKING UK DELEGATES FOR THEIR ASSESSMENT
OF POSSIBLE ALTERNATIVES TO REINTRODUCTION STATUTORY
POLICY.
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